

Message Text

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17

ACTION TRSE-00

INFO OCT-01 EUR-12 EA-06 ISO-00 AID-05 CIAE-00 COME-00

EB-07 FRB-01 INR-05 NSAE-00 RSC-01 XMB-02 OPIC-03

SP-02 CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15

STR-01 CEA-01 NEA-06 OPR-01 A-01 ABF-01 /083 W

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P R 260935Z NOV 74

FM AMCONSUL HONG KONG

TO SECSTATE WASHDC PRIORITY 2998

INFO AMEMBASSY MANILA

AMEMBASSY JAKARTA

AMEMBASSY LONDON

AMEMBASSY SEOUL

AMEMBASSY SINGAPORE

AMEMBASSY TAIPEI

AMEMBASSY TOKYO

C O N F I D E N T I A L HONG KONG 12829

PASS TREASURY AND FEDERAL RESERVE BANK

E.O. 11652: GDS

TAGS: EFIN HK

SUBJ: HONG KONG DOLLAR FLOATS UPWARD

SUMMARY: THE HONG KONG DOLLAR FLOATED UPWARD IN RESPONSE TO AN INFLOW OF FUNDS OVER THE PAST TWO WEEKS. IT IS NOW BEING QUOTED AT 2-3 PERCENT HIGHER THAN THE PREVIOUS LOWER INTERVENTION POINT. THIS IS THE WRONG POLICY GIVEN THE UNDERLYING DETERIORATING TRADE AND CURRENT PAYMENTS SITUATION.

1. (BEGIN UNCLASSIFIED) HKG ANNOUNCED ON THE EVENING OF NOVEMBER 25, "IN VIEW OF THE UNCERTAIN TRADING CONDITIONS NOW BEING EXPERIENCED ON THE FOREIGN EXCHANGE MARKET THE HONG KONG DOLLAR WILL NOT BE MAINTAINED, FOR THE TIME BEING, BETWEEN THE PERMITTED MARGINS OF HK\$4.9706/US\$1" AND 5.1994/1." HE FURTHER STATED THAT THE GOVERN-
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MENT HAD BEEN FORCED TO INTERVENE TO MAINTAIN THE \$4.97/1 RATE

BUT "IN VIEW OF THE SELLING OF U.S. DOLLARS THAT HAS DEVELOPED IN THE PAST FEW DAYS, THE GOVERNMENT HAS DECIDED NOT TO COMMIT STILL FURTHER RESOURCES IN ORDER TO MAINTAIN THE RATE"

2. THE MARKET OPENED ON NOVEMBER 26 AT 4.75, THEN DEPRECIATED TO 4.80 BY NOON, CLOSING IN THE 4.80-4.85 RANGE. (END UNCLASSIFIED)

3. (BEGIN CONFIDENTIAL) THE HONG KONG DOLLAR HAS BEEN APPRECIATING VIS-A-VIS THE U.S. DOLLAR SINCE LATE OCTOBER. THE RATE HOVERED JUST ABOVE THE UPPER INTERVENTION POINT FOR THE TWO WEEKS PRIOR TO NOVEMBER 18, WHEN HKG INTERVENTION BEGAN ON A SMALL SCALE. SALES OF U.S. DOLLARS INCREASED THROUGHOUT THE WEEK AS THE RATE REMAINED ON THE FLOOR. ON NOVEMBER 25, SELLING BECAME VERY INTENSE AND HKG INTERVENTION MAY HAVE BEEN BETWEEN \$50 MILLION IN A MARKET WHERE \$10-20 MILLION PER DAY IS CONSIDERED NORMAL.

4. THE CAUSE OF THE RECENT INFLOW OF MONEY IS UNKNOWN. THERE ARE THE USUAL RUMORS OF ARAB LOANS AND INVESTMENTS, A FLOW OF MONEY FROM SINGAPORE AND MALAYSIA FOR INTEREST RATE REASONS AND FOREIGN BANK BORROWING. FINALLY, MORE RECENTLY, THE MOVEMENT OF THE RATE, ITSELF, HAS PROVOKED SPECULATION.

5. APPRECIATION OF THE EXCHANGE RATE WOULD SEEM TO BE THE WRONG POLICY FOR HONG KONG. ALTHOUGH NO BALANCE -OF-PAYMENTS IS CALCULATED IN HONG KONG, THE DOUBLING OF THE TRADE DEFICIT AND THE STAGMATION OF TOURIST EARNINGS INDICATES THAT THE CURRENT ACCOUNT SITUATION HAS DETERIORATED. NEVERTHELESS, THE EXCHANGE RATE, FREE TO MOVE OVER A 4.5 PERCENT RANGE, AND STRENGTHENED BY INFLOWS OF MONEY IN RESPONSE TO LOCAL TIGHT MONEY CONDITIONS HAS REMAINED SLIGHTLY STRONGER THAN PARITY, 5.08/1, MOST OF THE YEAR.

6. THE GOVERNMENT HAS BEEN EXTREMELY CAUTIOUS IN INTERVENING IN THE MARKET, ALLOWING THE RATE TO FALL TO THE FLOOR, BEFORE COMING IN AND THEN ONLY IN NOMINAL AMOUNTS UNTIL THE LAST DAY. IT SEEMS TO START FROM THE PREMISE THAT IT WOULD BE OVERWHELMED AND THAT IT WOULD SUFFER LOSSES (ON THE BOOKS AT ANY RATE.) IT NOW HOPES THAT THE SITUATION WILL BE SHORT-LIVED AND THAT THE MARKET WILL MOVE BACK WITHIN THE OLD INTERVENTION POINTS SO THAT A FIXED RATE CAN BE REESTABLISHED.
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7. THE DECISION WAS TAKEN HASTILY BY THE EXECUTIVE COUNCIL, WITHOUT CONSULTATION WITH THE HONG KONG AND SHANGHAI BANK, THE COLONY'S SEMI-OFFICIAL CENTRAL BANK, TO THE LATTER'S DISMAY, IRRITATION AND DISAGREEMENT. THE EXCHANGE BANK ASSOCIATION, CHAIRED BY THE HONG KONG BANK, WHICH SETS THE MAXIMUM DEPOSIT INTEREST RATES, HAS ON ITS OWN, REDUCED INTEREST PAID SHARPLY, EFFECTIVE NOVEMBER 27, IN EFFORT TO PUSH OUT

SPECULATIVE MONEY. THIS IS THE THIRD CUT IN TEN DAYS AND THE FOURTH IN A MONTH. THE TABLE BELOW MAKES A COMPARISON TO THE SITUATION AS OF A MONTH AGO:

	SEVEN DAY CALL					
	1M.	3M.	6M.	12M.		
OCT. 29	9.5	10.0	10.25	10.25	10.25	
NOV 27	6.0	6.74	8.50	9.00	9.00	

AT THE SAME TIME, THE "PRIME RATE" HAS FALLEN FROM 12.0 PERCENT TO 10.5 PERCENT.

8. THE RATE WILL PROBABLY DEPRECIATE AGAIN IN THE NEXT FEW DAYS AS SPECULATOR'S COVER THEIR POSITIONS. OVER THE SLIGHTLY LONGER RUN, AN IMPORTANT INFLUENCE WILL BE THE STRENGTH OR WEAKNESS OF THE U.S. DOLLAR AGAINST THE MAJOR EUROPEAN CURRENCIES. A PART FROM THAT THE CURRENT BALANCE -OF -PAYMENTS AND THE INTEREST RATE POLICY PURSUED BY THE BANKS SUGGEST THAT THE RATE WILL FALL BACK TO THE OLD INTERVENTION RANGE EVENTUALLY.
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